

January 30, 1997

**VIA UPS Next Day Air**

Docket Unit  
California Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, CA 94102

Re: Application to Adopt Performance-Based Regulation (PBR) for Base Rates (A. 95-06-002)

Dear Docket Clerk:

Enclosed for filing in the above-entitled matter are the original and five copies of the **OPENING BRIEF OF THE CALIFORNIA ENERGY COMMISSION ON SOUTHERN CALIFORNIA GAS COMPANY'S APPLICATION TO ADOPT PERFORMANCE-BASED REGULATION(PBR)FORBASERATES**. We request that a copy of this document be file-stamped and returned for our records. A self-addressed envelope is enclosed for your convenience.

Your courtesy in this matter is appreciated.

Very truly yours,

CARYN J. HOUGH  
Attorney for the  
California Energy Commission

cc: A.95-06-002 service list

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA

In the Matter of the Application	)	
of Southern California Gas Company	)	A.95-06-002
to adopt the Performance-Based	)	
Regulation (PBR) for Base Rates.	)	
_____	)	

**OPENING BRIEF OF THE CALIFORNIA ENERGY COMMISSION  
ON SOUTHERN CALIFORNIA GAS COMPANY'S APPLICATION TO  
ADOPT PERFORMANCE-BASED REGULATION (PBR) FOR BASE RATES.**

January 30, 1997

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## INTRODUCTION

The California Energy Commission (CEC) appreciates the opportunity to submit this Opening Brief on the Application of Southern California Gas Company (SCG) for the adoption of Performance-Based Regulation (PBR) to apply to its base rates. The California Public Utilities Commission (Commission) has an opportunity in this case to make a number of important decisions to support the continued development of a competitive market for energy services. Although the provision of natural gas and related services is not subject to the same legislative mandates that will dramatically transform the market for the provision of electricity and related services, the Commission nonetheless can and should base its decision on the same principles that led to the electricity industry restructuring efforts. It should ensure that its decision 1) encourages economically efficient pricing that is transparent to customers; 2) provides for consistent treatment of energy efficiency programs as between gas and electric utilities; 3) encourages energy efficiency efforts that transform energy efficiency markets; and 4) restrains SCG from using intangible assets acquired as a consequence of its regulated monopoly status to unfairly compete with other providers of energy services. These Commission actions will help ensure that the benefits created by increased consumer choice and more competitive energy markets will be available to all energy customers.

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## ARGUMENT

### I. THE COMMISSION SHOULD REJECT SOCAL'S PROPOSAL TO REPLACE THE CORE FIXED COST ACCOUNT WITH THE ENERGY EFFICIENCY ADJUSTMENT FACTOR AND THE WEATHER NORMALIZATION MECHANISM.

#### A. The Commission Should Reject the Weather Normalization Mechanism Because It Doesn't Provide Customers with the Ability to Respond to Price Signals.

"The central tenet of the [CEC's] vision for the electric industry restructuring has been to maximize economic efficiency through consumer choice -- the principle criterion for judging success." (*ER 94*, p. 23) However, consumers cannot maximize economic efficiency by exercising choice about their consumption of natural gas if they do not have consistent prices to which to respond. We believe that SCG's proposal to change the way in which base rates are adjusted for weather-related fluctuations may have the unintended effect of dampening accurate price signals to consumers and should therefore be rejected.

It is the Commission's policy to protect SCG from the risks associated with weather-induced throughput fluctuations, and no party to this case opposes that general concept. SCG proposes to replace the current annual adjustment with its "weather normalization mechanism" (WNM), which SCG describes as a "real time" adjustment that results in downward adjustments to the bill in colder-than-average months and upward adjustments in warmer-than-average months. (Exh. 11, pp. 43-44.) While it may be desirable for customers to pay less per therm when it is colder and their gas consumption is higher, we are persuaded by testimony of The Utility Reform Network (TURN) that the WNM will cause other effects which are less desirable. Specifically, we believe that the WNM may interfere with customers' ability to estimate the price they pay for natural gas and adjust their consumption accordingly.

The WNM will create a weather-related adjustment to the per-therm price of gas customers pay for each month that is either warmer or colder than average. However, customers will not know whether an WNM adjustment has been made or what its

effect on price is until after completion of the billing cycle in which the adjustment is made. (Exh. 11, p. 43-44.)<sup>1</sup> This means that customers may not know the price of the gas they are consuming each month, and can therefore not adjust their consumption to reflect that price. According to TURN, per-therm price changes of plus-or-minus 10% from month to month will not be uncommon, and price fluctuations may range as high as 30 - 50%. (Exh. 62, p. 9.) The CEC supports utility efforts to offer customers the ability to reduce the risk of bill fluctuations, but believes that the most appropriate way to do so is by offering balanced bill payment options or announcing seasonal prices in advance, and not through encouraging price volatility which doesn't reflect typical market processes and which hinders customers' ability to respond price signals. We therefore encourage the Commission to reject SCG's proposal to implement the WNM.

B. The Energy Efficiency Adjustment Factor Is More Complicated than the Core Fixed Cost Account Without Providing Additional Advantage.

SCG proposes to implement a new mechanism, the Energy Efficiency Adjustment Factor (EEAF) to account for energy efficiency-induced fluctuations in sales. SCG claims that this mechanism is necessary because SCG does not recover all of its fixed costs in the fixed portion of the customer charge for residential customers. (5 Tr. 536; SCG; Barker) SCG claims that the EEAF will therefore only recover the undercollected fixed charges that are currently collected in volumetric rates from residential customers. (*Ibid.*) SCG also states that if its proposal to gradually increase the residential customer service charge to \$12 per month is approved, the actual adjustment will also be gradually reduced to zero. (*Ibid.*)

As discussed below, the CEC strongly supports the concept of collecting fixed costs in a fixed charge. In fact, one benefit of doing so would be to eliminate the necessity for adjustment mechanisms such as the EEAF. However, the testimony

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<sup>1</sup> Furthermore, even if the price information is made available to customers in advance, the adjustment itself seems counter to the workings of typical competitive markets, in which increased demand is usually met by a price increase, not decrease.

filed in this case raises several unanswered questions about SCG's claim that \$12 per month is the correct amount of the fixed charge for residential customers. If, after the Commission determines the correct amount of fixed charges, it decides for policy reasons or legal constraints imposed by PUC § 739.7 to disallow full recovery of those costs through a fixed charge, we recommend that the energy efficiency adjustment be made through retention of the existing Core Fixed Cost Account (CFCA), and that SCG's request to establish the EEAF be denied.

The reason for our opposition to the EEAF is simple - it's too complicated. The CEC testified that SCG's proposed mechanism will create difficulties in estimating energy savings created by a broad range of energy efficiency measures. (Exh. 53, p. 2.) These concerns were echoed by the Office of Ratepayer Advocates (ORA), which stated that the EEAF will require, "on-going monitoring, measurement, and verification of utility-reported load reductions from energy efficiency. . . Measurement [will be] a tedious process, replete with a multitude of opportunities for gaming, distortion and (inevitably) disputes about the utility claim for therm reductions to be included in the EEAF." (Exh. 107, p. 11-14.) TURN and the Natural Resources Defense Council also testified that the EEAF would be complicated and could lead to disputes. (Exh. 62, pp. 11-12; Exh. 54, pp. 5-6.) The CEC urges the Commission to reject the use of a new, more complicated and contentious mechanism, and simply retain the CFCA to accommodate energy efficiency-induced fluctuations in sales.

**II. THE COMMISSION SHOULD NOT AUTHORIZE AN INCREASE IN SCG'S RESIDENTIAL SERVICE CHARGE UNLESS IT EXPRESSLY FINDS THAT THE INCREASE PROPOSED BY SCG ACCURATELY REFLECTS FIXED COSTS.**

In keeping with our previously stated position that pricing of energy services and commodities should be economically efficient pricing, we recommended that the Commission allow SCG to recover its fixed costs in a fixed service charge. (Exh. 53, p. 2) SCG also supports the use of a fixed charge to collect fixed costs and has proposed to raise its service charge for residential customers from \$5 per month to \$12 per month in pursuit of that objective. (Exh. 11, pp. 10-11.) However, testimony filed by TURN indicates that one issue associated with SCG's fixed costs is the

potential cross-subsidization of new customers by existing customers. (Exh. 62, p. 16.) We have not ascertained whether a fixed cost of \$12 per month for residential customers is reasonable. While we support collecting fixed costs in a fixed charge, we recommend that the Commission not grant SCG's request to increase the customer service charge to \$12 per month absent a careful examination of whether that amount in fact reflects fixed costs and is not a subsidy from one group of ratepayers to another.

III. TO ENSURE CONSISTENT TREATMENT BETWEEN ELECTRIC AND GAS UTILITIES, THE COMMISSION SHOULD REQUIRE SCG TO COLLECT ITS ENERGY EFFICIENCY FUNDING THROUGH A NON-BYPASSABLE SURCHARGE AND TO ADMINISTER THE PROGRAMS THROUGH THE USE OF AN INDEPENDENT ADMINISTRATOR.

The Commission has recently reaffirmed its commitment to support utility pursuit of energy efficiency opportunities not pursued by other entities, as mandated by Public Utilities Code § 701.1. (D.95-12-063 as modified by D.96-01-009, p.156.) At the same time, the Commission is encouraging a new approach to funding and administering these programs. In its Restructuring Decisions, the Commission has suggested to the Legislature the adoption of a surcharge to fund energy efficiency activities. (*Id.* at p. 157.) This surcharge was adopted by the Legislature for electric utilities as part of electric industry restructuring. (Public Utilities Code § 381(c)(1)) The CEC believes that there is no reason that the funding mechanism for gas utility energy efficiency activities should be any different from that for electric utilities.<sup>2</sup>

The Commission also believes that these funds should, after a transition period, be administered by an independent organization. (D.95-12-063 as modified by D.96-01-009, p.157.) The CEC supports this position and believes that an independent administrator can avoid some of the inherent conflicts of interest that a

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<sup>2</sup> A Draft Decision on Public Purpose Programs, issued by Commissioners Neepor and Knight on January 17, 1997 indicates that the Commission will be asking the Energy Division to file a report on extending the surcharge to gas customers for other public purpose programs, including research, development and demonstration, and low-income assistance. The CEC strongly supports that directive.

utility faces when administering programs which are cost-effective and statutorily mandated, but which cause short term revenue losses to the utility.

SCG argues in its rebuttal testimony that the use of an independent administrator and a surcharge is unnecessary. SCG claims that a surcharge would put SCG and its shareholders at a disadvantage relative to the risk faced by electric utilities and their shareholders, but provided no evidence to support this claim. (Exh. 130, p. 20.) We fail to understand how a Commission decision requiring SCG to collect its DSM funding in a fixed charge creates any risk for SCG, with or without comparison to electric utilities. Moreover, SCG's rebuttal fails to acknowledge the fact that the Commission encouraged stakeholders in the restructuring process to pursue consistent treatment between gas and electric utilities. (D.95-12-063 as modified by D.96-01-009, at p. 158, ft. 63.) SCG's claim should be rejected.

SCG also claims that such a surcharge is unnecessary given SCG "maintenance" of a robust level of energy efficiency efforts. (Exh. 130, p. 20.) However, this statement ignores the dramatic reduction in SCG's energy efficiency funding since 1993: \$73.3 million in 1993 to \$65 million in 1995 to \$36 million in 1996. (Exh. 53, p. 3.) SCG's recent funding levels provide scant comfort to those concerned about the company's commitment to energy efficiency.

SCG also argues that use of an independent administrator will "reverse the trend toward participant-funded programs. . . ." (Exh.130, p. 20.) In the first place, it is difficult to understand why this would be so. An independent administrator has the same ability as a utility to implement participant-funded programs. Second and more important, SCG's statement incorrectly implies that the Commission's goal for energy efficiency is participant-funded programs. In fact, the Commission's vision is much broader, encompassing a "two-track" approach to energy efficiency, in which public funding of energy efficiency is directed expressly towards those activities not otherwise provided by the competitive market. (D.95-12-063 as modified by D.96-01-009, p.156.) There is nothing about the implementation of market transformation and other public policy programs which hinders participant funding.

Finally, we note that the same arguments that SCG has made in this proceeding have recently been rejected in the Draft Decision on Public Purpose



Programs (Draft Decision), issued January 17, 1997 by Assigned Commissioners Knight and Neeper. In the Draft Decision, the Commissioners state, "We believe that the need for comparable treatment of electricity and gas consumption overrides SoCal's arguments for differing treatment of gas and electric public purpose programs. . . . We intend to establish a gas surcharge mechanism that will apply to all public purpose areas and ultimately to all gas customers." (Draft Decision, p. 64.) And proposed Conclusion of Law 2 states that, "The administrative structures for . . . energy efficiency. . . should apply to both gas and electric programs. Funds currently in rates for gas demand-side management programs . . . should be transferred to the respective boards, and ultimately to the selected program administrators in each respective service territory." The CEC's recommendations will support this process and should be adopted as part of the decision in this proceeding.

**IV. THE COMMISSION SHOULD AUTHORIZE AN ENERGY EFFICIENCY BUDGET OF \$30.9 MILLION AND DIRECT SCG TO SPEND \$5 MILLION ON MARKET TRANSFORMATION EFFORTS.**

As noted above, the Commission has endorsed the "two-track" approach to energy efficiency, and specifically enumerates market transformation as an appropriate goal for publicly-funded energy efficiency programs. We believe that the Commission's support of utility pursuit of track-two efforts, including market transformation, should be reflected in its funding decisions for both electric and gas utilities. As a result, the CEC filed testimony in this proceeding recommending that SCG's proposed budget of \$25.9 million be increased to \$30.9 million, with the additional \$5 million be used to develop and implement market transformation programs. (Exh. 53, p. 2.) The CEC offered specific examples of the kinds of market transformation opportunities that are available in three different market sectors. (*Id.* at p. 3.) Moreover, SCG itself states that it is already implementing energy efficiency programs that have market transformation effects. (8 Tr. 995; SCG; Emmrich)

In light of the Commission's support for market transformation programs and SCG's recent efforts in this area, designating \$5 million from SCG's energy efficiency funds specifically for market transformation programs is reasonable. We encourage

the Commission to include such a requirement in its decision on this application.

V. THE COMMISSION SHOULD PROHIBIT SCG FROM PROVIDING NEW PRODUCTS AND SERVICES.

When we originally filed testimony in this proceeding, we recommended that the Commission allow SCG to enter the new products and services market with certain conditions, including paying ratepayers for the value of any ratepayer assets SCG uses as well as making those assets available to other companies at the same price. (Exh. 53, p. 4) However, during the course of hearings, it became apparent that the SCG proposal is so broad in scope that we are now compelled to oppose any aspect thereof.

SCG states that all of its corporate assets, tangible or intangible, belong to its shareholders; in other words ratepayer assets within SCG do not exist. (Exh. 144, pp. 2, 31; 6 Tr. 701-702; SCG; Reddy) SCG states that it may choose to make these assets available to unregulated affiliates for a fee (Exh. 144, p. 3), but would not make those assets available to competitors. (6 Tr. 697; SCG; Reddy) Moreover, some of the assets that SCG itself uses could be confidential. (6 Tr. 672, SCG; Reddy)

SCG acknowledges that it built up many of its assets as a result of its years of operation as a regulated monopoly, with an opportunity for a guaranteed rate of return. (5 Tr. 608; SCG; Reddy) Despite SCG's assertion that the opportunity it had to develop intangible assets as a regulated monopoly is the same opportunity that unregulated businesses have (6. Tr. 685; SCG; Reddy), the CEC believes that allowing SCG to go forward with its proposal at this time would clearly create a competitive inequity. SCG and its unregulated affiliates will be able to use many assets which were acquired as a result of its history as a monopoly, including intangible assets such as its name and billing system, to compete with entities that do not have access to those assets or a comparable opportunity to acquire them. The CEC believes that this is unfair and should be prohibited by the Commission. Under these circumstances, SCG should be denied the opportunity to market new products and services, and its assets should not be made available for use by unregulated subsidiaries or affiliates in these activities unless they are also made available on the

same terms to competitors. Any other outcome would provide SCG and its affiliates an unwarranted competitive advantage.

## **CONCLUSION**

For the reasons specified above, the CEC recommends that the Commission:

- o Reject SCG's proposal to replace the CFCA with the WNM and the EEAF;
- o Deny SCG's request to increase the residential service charge unless it expressly finds that the increase proposed by SCG accurately reflects fixed costs;
- o Require SCG to collect its energy efficiency funding through a non-bypassable surcharge and to prepare for a transition to program administration by an independent administrator;
- o Authorize an energy efficiency budget of \$30.9 million and direct SCG to spend \$5 million on market transformation efforts; and
- o Prohibit SCG from providing new products and services.

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With these actions, the Commission will be affirmatively supporting the continued development of a competitive market for energy services. SCG customers will be able to enjoy the benefits of transparent, economically efficient pricing, energy efficiency efforts that transform energy efficiency markets, and protection from the unfair competitive advantage SCG could exercise over other market participants in selling new products and services.

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Respectfully submitted,

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